# Non-euro countries in the EU after Brexit: between fear of losing of political influence and Euro accession

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# Non-euro Countries in the EU after Brexit

**Between Fear of Losing of Political Influence and Euro Accession**

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**Despite the United Kingdom never having adopted the euro, the upcoming Brexit will have consequences not only for the European Union as a whole but also for monetary integration. The UK's withdrawal from the EU will heighten fears among the 'euro-outs', the eight Member States that have not adopted the euro, that their influence over the Union's decision-making processes will diminish in the future. Their concern has led to the formation of a new coalition of states uniting the interests of the northern euro members and some countries outside the eurozone. Although the debate over enlarging the eurozone is now subsiding, the 'Brexit moment' could trigger a new dynamic and act as a driver for expanding the eurozone or strengthening some non-euro states' links to the banking union.**

The eight euro-outs (Bulgaria, Denmark, Croatia, Poland, Romania, Sweden, the Czech Republic and Hungary) are a heterogeneous group of countries that follow very different economic models and are at different stages of economic development. For example, Denmark's gross domestic product (GDP) per capita is seven times higher than that of Bulgaria. There is also a considerable gap in the competitiveness of the non-euro states. According to the *Global Competitiveness Report 2018*, Sweden and Denmark are among the most competitive countries in the world. They occupy the ninth and tenth places in the ranking. The other non-euro states, which are currently plagued by political instability and institutional weaknesses, still base their competitiveness on low wages. The size and importance of their financial sectors to their economies also vary widely within the group. The share of banking sector assets to GDP is three times higher in Denmark than it is in Poland. Central and Eastern European countries faced immense challenges during the global financial crisis as their banking sectors were largely owned by foreign banking groups. This meant that national banking authorities were only able to perform their supervisory tasks to a limited extent. All these differences mean that non-euro countries have quite different priorities when it comes to EU legislation in the field of financial regulation.

The dynamics of economic growth in these euro-out countries are affected by

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their different stages of economic development. The less developed among them often achieve higher growth rates due to the catch-up effect. With the exception of Sweden and Denmark, whose economic growth in 2017 was slightly below the euro area average of 2.4 percent, the economies of those EU Member States outside the euro area that are less economically developed grew much faster.

The individual relationships of the euro-outs to the euro and the eurozone are also very different. Most of them pursue independent monetary policies. Denmark has been a member of the Exchange Rate Mechanism 2 (ERM 2) since 1999 and conducts a fixed exchange rate policy against the euro. Before that, from 1982, the Danish krone was pegged to the deutschmark. After Brexit, Denmark will be the only state with an opt-out clause from the third stage of the Economic and Monetary Union. All other EU countries are contractually obliged to adopt the euro as soon as they meet the convergence criteria. In the case of Denmark, the op-out clause was agreed after a referendum in 1992 failed to secure a majority in favour of ratifying the Maastricht Treaty and the introduction of the euro was rejected in another referendum in 2000.

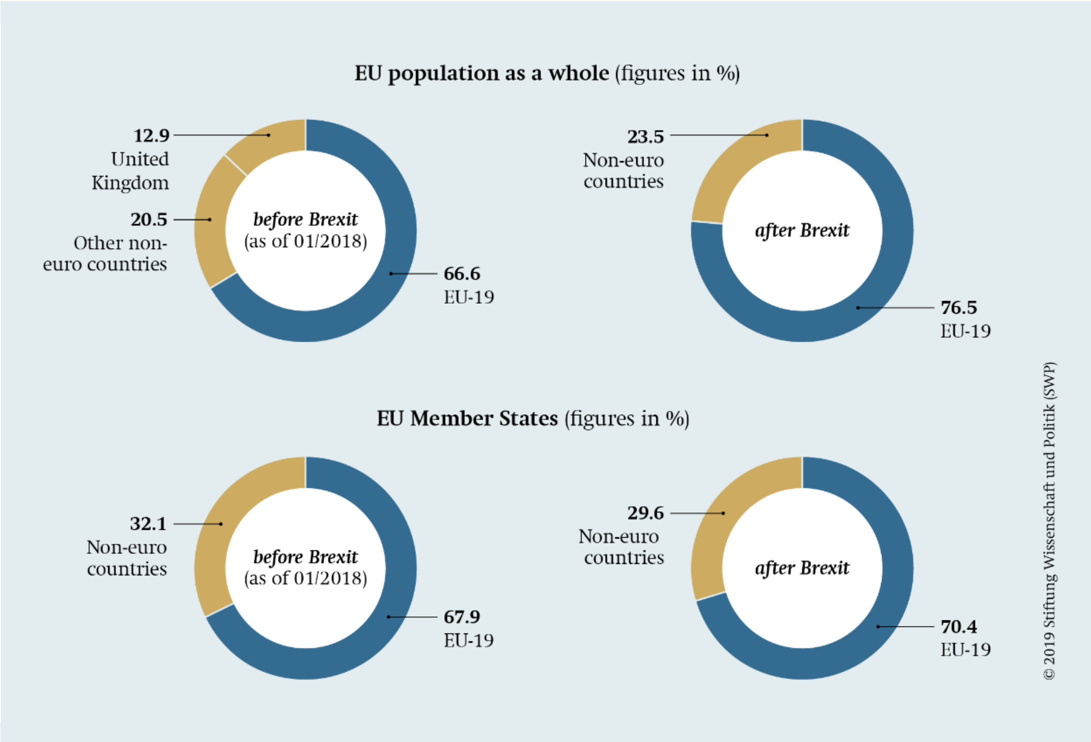
The Bulgarian lev is pegged to the euro at a fixed rate as part of a currency board arrangement. Romania and Croatia maintain exchange rate regimes with a managed floating exchange rate against the euro. Croatia's relationship to the single currency is very special. The country's economy is largely 'euroised'. Around 75 percent of assets and 67 percent of liabilities are denominated in euros.

All countries in the group are open economies interested in deepening the single market. Furthermore, they are all in favour of the euro area being open to new members. At the same time, they support euro area integrity, even though they are unwilling to bear the necessary stabilisation costs. The economic diversity of the non-euro countries and their different relationships to the euro and the euro area make it difficult for the euro-outs to cooperate politically with one another within the EU. This increases their risk of losing influence within the Union after Brexit.

## Superior numbers of eurozone members in the EU

For the euro-outs, the UK's withdrawal represents a political power shift within the EU. The exit from the EU of one of the largest member countries will also mean the departure of a major non-euro state from European decision-making processes. For some states and groups of states, this will increase their voting power in the Council of the European Union. This fundamental change will be due to the disappearance of around 13 percent of the total population of the EU. Around 80 percent of the legislation that the Council has to ratify is subject to a system of double qualified majority voting. Accordingly, in order for a bill to be adopted, it requires the support of at least 55 percent of Council members who must also represent at least 65 percent of the EU's citizens. The removal of the UK and its population from the double qualified majority calculation will increase the population share of eurozone members compared to the EU as a whole. After Brexit, the EU-19 will represent 70.4 percent of Member States and 76.5 percent of the total EU population (see figure). The 'blocking minority', which can block a bill that has to be passed by a double qualified majority, will be more difficult for the euro-outs to achieve. Article 238(3)a TFEU stipulates that a coalition of four states together representing at least 35 percent of the EU population may reject a bill. It was already very complicated to achieve this blocking minority before Brexit; after Brexit, it is likely to be impossible to overrule a united eurozone in the Council.

The impact of the superior numbers of euro area countries on voting procedures in the Council will be limited if the body maintains its tendency to take decisions by consensus. Brexit will be less significant in those areas of the single market where




Council decisions can only be taken unanimously (e.g., EU Multiannual Financial Framework or social security and social protection legislation). However, the expected predominance of the EU-19 over other Member States due to their superior numbers reinforces concerns about a reduction in their influence on decision-making in the European Union.

Although there is currently little potential for conflicts of interest between the EU-19 and the EU-8, further integration, particularly in the field of financial markets, may lead to increasing dissent. The conflicts between the euro-ins and the euro-outs do occur, as demonstrated during the discussions on the creation of banking union in 2012. The UK, in particular, feared that the interests of the EU-19 would prevail at the European Banking Authority (EBA), which is responsible for setting common supervisory standards in the banking sector of the single market. Under pressure from London, a special voting system was therefore agreed for the EBA: a decision by the Board of Supervisors requires a double simple majority of EU states inside and outside the euro area. The UK's exit from the EU is, therefore, likely to weaken the EU-8's negotiating position inside the EBA. Moreover, the double majority system in the EBA will no longer be used once at least four of the euro-outs participate in the banking union's Single Supervisory Mechanism (SSM).

However, the UK's strength in the EU has not only been formally reflected in the weighting of its vote in legislative processes, but has also made itself felt at an informal level. The UK has used many channels to safeguard its economic and political interests in the EU. It has always had a strong influence on single market legislation, for example, by ensuring that UK experts filled relevant key positions in EU institutions. In addition, London has strongly supported the deepening of the single market in services, digitisation and energy, an attitude that was in line with that of all EU members outside the euro, in particular the Central and Eastern European countries. Then again, criticism of one of the foundations of the single market, namely the free movement of people, especially from new Member States, was a key issue in the Brexit debate in the UK.

The UK's exit from the EU may have other consequences. It might strengthen the Franco-German duo. Such a development could be a problem for certain smaller states, as the major euro countries already have a greater impact on decision-making and agenda-setting with their representatives filling key EU positions.

## Euro-outs and EU coalitions

The shift in voting rights in the overall structure of the EU Council will not affect dynamics among the euro-ins. Whether the superior number of eurozone countries predominance in the Council leads to them dominating the EU's legislative and agenda-setting processes will depend very much on how united the euro countries are in defending their interests. Although members of the monetary union are closely linked in many respects, their positions and weight in European politics vary widely.

Different divisions can be identified in groups of states within the eurozone. One camp includes those countries that focus on making budgetary policy more flexible, on risk sharing and on more fiscal transfers in the euro area. This group mainly includes the southern members of the euro area, such as France, Italy, Greece, Spain, Portugal, Cyprus and Malta. Representatives of these countries meet regularly at informal Southern EU Summits.

Then there is the group of states whose economic policy is primarily based on individual responsibility for economic policies and who insist on compliance with fiscal rules. Germany, the Netherlands, Finland, Austria and a few other countries such as Slovakia and the Baltic countries are in this camp. These groups have been focusing their political efforts on maintaining budgetary discipline, reducing risk, stricter implementation of rules and promoting structural reforms. The two camps hold opposing views on the future direction of eurozone reforms.

At the end of 2017, at the initiative of the Netherlands and Ireland, some countries in the second group met in a new format. The alliance consisted of eight countries and included the euro states Estonia, Finland, Ireland, Latvia, Lithuania, the Netherlands and the two euro-outs Denmark and Sweden. It later named itself the New Hanseatic League and in a statement on 6 March 2018 declared it was in favour of maintaining monetary union as an inclusive format that was also open to non-euro states. The group stands for compliance with the common rules and economic self-responsibility among eurozone members. The banking union project should be fully implemented, provided there is sufficient risk reduction in the banking sector, and the European Stability Mechanism (ESM) strengthened and expanded to a European Monetary Fund. However, this institution should retain its intergovernmental character. The new alliance, which is becoming increasingly formalised, could take effect at Council level, not only attempting to block proposals from other euro states, but also working towards curbing Franco-German dominance. In June 2018, the Netherlands, an informal spokesman for the group, protested against the Franco-German proposal to set up a separate eurozone budget.

Deepening the single market and, in particular, further integrating the capital markets (Capital Markets Union, CMU) is another important objective of the New Hanseatic League. The initiative to create a Capital Markets Union was launched by the European Commission in 2015. The purpose of the CMU is to address the lack of diversified sources of capital in the financial sector which leads to overdependence on the banking sector. Brexit will make it more difficult to implement the Capital Markets Union project since the main sponsor of this project, the UK, which also has the most developed financial market in the EU, will be missing. In a joint declaration from July 2018, the eight members of the New Hanseatic League pledged to continue implementing the Capital Markets Union. On 2 November, the finance ministers of the new cooperation alliance, which now comprises ten countries following the accession of the Czech Republic and Slovakia, made a statement about the ESM reforms. In it, they reaffirmed the importance of ESM reforms for the EU as a whole, stressing the need to keep the banking union open to non-euro countries.

The Hanseatic Group is an example of how successful joint representation of euro-ins and euro-outs can be on the issue of eurozone reforms. The fact that only two Visegrád countries are members of the co-operation raises doubts about the ability of Poland, Slovakia, the Czech Republic and Hungary to jointly pursue their objectives on euro area reform. The Visegrád Group (V4) was able to defend its interests quite well in negotiations on the current EU Multiannual Financial Framework 2014—2020. Although the increased integration of the euro area may lead to fragmentation of the single market, the V4 appear neither to be united nor interested in the current debate on Economic and Monetary Union. Eurozone reforms are only a marginal topic at V4 meetings. The capability of other non-euro states such as Bulgaria, Romania and Croatia to form alliances is negligible due to their low shares of EU-27 population and economic weakness.

## From euro-outs to euro-ins?

The UK's departure from the EU throws up questions as to how the balance of power in a post-Brexit Union and the further integration of the euro area might affect the propensity of non-euro states to adopt the single currency. The first step is to determine whether Brexit will influence the configuration of the eurozone and accelerate its enlargement.

During the euro crisis, the UK government's positions on many issues made crisis management more difficult. Although it granted Ireland a bilateral loan in 2011, it rejected any further use of the EFSM which used the EU budget as collateral for bailout packages. London also opposed adoption of the European Fiscal Pact which was therefore concluded outside the EU legal framework. However, the UK's exit from the EU will not make the implementation of eurozone reforms any easier because of the enormous number of conflicting interests among the EU-19.

However, Brexit will make it easier for euro area members to make exclusive use of instruments designed for the EU as a whole. The exit of the largest non-euro state and one of the largest net contributors to the EU budget will allow the EU-19 to use some budget lines for sole purposes. After Brexit, the only euro outs that are net contributors to the EU budget will be Sweden and Denmark. With the UK gone, there will also be a statistical shift in wealth within the EU. The new EU Member States will be statistically richer, which could lead them to facing lower financial flows from the EU budget and, in particular, from Cohesion Policy allocations. In turn, this could lead to EU budget transfers being redirected to southern eurozone members.

Other major reform projects in the eurozone include completing the banking union and expanding the tasks of the ESM. These projects are important for stabilising the eurozone and increasing its resilience to crises. Contrary to non-euro countries' fears, they do not risk forming a "Hard-core" Europe. The banking union was initiated in 2012. While the measures associated with it are primarily aimed at the euro states, for whom membership is mandatory, participation in the Single Supervisory Mechanism of the banking union is also possible for non-euro countries. However, SSM members outside the euro area do not have access to the European Central Bank (ECB) and the ESM facilities. The influence of a euro-out state on the decision-making process in the banking union is also very limited. Most EU countries outside the euro area will, therefore, have a rather cautious approach towards the banking union. On the other hand, after exposing corruption scandals at the Slovenian and Latvian central banks, the ECB and some members of the eurozone are very reluctant to admit new Member States with weak national institutions.

The recent case of massive money laundering at Danske Bank shows that banking supervision needs to be strengthened and more centralised, not only in the euro area but throughout the single market as a whole. This could intensify pressure on Copenhagen to join the SSM. Sweden, whose banking sector is dominant in the Baltic States, should also be encouraged to join the SSM for the same reasons.

Although all EU countries, except Denmark and the UK, have a legal obligation to participate in the monetary union, this obligation is not linked to any timetable. It has also never been an object of political pressure. The most likely candidates to introduce the euro are the EU's three poorest countries: Romania, Bulgaria and Croatia. Theoretically, Bulgaria currently meets almost all convergence criteria, but the country's structural problems, corruption and weak institutions are standing in the way of Sofia's path to membership. There is also an urgent need for measures to improve the institutional environments and economic conditions in Romania and Croatia. Croatia currently has the most difficult economic situation. It is battling excessive macroeconomic imbalances and facing a high public debt to GDP ratio (78 percent in 2017). Private and public debt, which is largely held in foreign currencies, remains a source of vulnerability for the Croatian economy.

An important factor in adopting the euro is public support for the single currency. According to Eurobarometer surveys conducted in May 2018, the majority of respondents in Romania (69 percent), Hungary (59 percent) and Bulgaria (51 percent) support the introduction of the euro. In Poland, 48 percent are in favour and in Croatia the figure is 47 percent. Sweden (40 percent) and the Czech Republic (33 percent) are the least willing to adopt the euro. These sentiments influence the policy strategies of the euro-outs. In Poland, the Czech Republic and Hungary, the national currency is considered a symbol of state independence. It is, therefore, unlikely that Prague and Warsaw will accede to the eurozone. Budapest, on the other hand, is keeping this question open.

## Outlook: consequences and recommendations

To date, knowledge of the upcoming Brexit has not significantly changed the euro-adoption plans of the euro-outs. However, the new realities of life in the EU after Brexit are likely to persuade these countries to revise their cost-benefit calculations for joining the euro, or at least to have closer links with the euro area. All the euro-outs are already becoming concerned about losing influence over EU decision-making after Brexit. These concerns are not only due to the lack of an effective blocking minority but also due to the inability of non-euro states, with their differing interests, to act as a coherent group in the EU. The euro-outs are not subject to the same degree of risk from marginalisation: Sweden, Denmark and the Czech Republic are in a better position to articulate their interests through the New Hanseatic League. On the other hand, there are countries like Poland, whose isolation in EU politics is mostly due to domestic developments and which is likely deepen further as a result of Brexit.

The first test of the political weight of the euro-outs will be who fills which key positions at the EU institutions after the European parliamentary elections in May 2019. These important functions include the President of the European Council and Euro Summit, certain portfolios in the European Commission and cabinet member posts. The appointment of some candidates from eurozone countries such as Slovakia, Slovenia or the Baltic States to key EU positions could convey the message that the political and financial risk of joining the euro is one worth taking. However, the main obstacle to pushing through this idea is the relatively small number of experienced politicians in the new Member States who would be suitable for these posts.

The UK's withdrawal from the EU could be used to build up new momentum among non-euro countries to adopt the euro. This could encourage the countries concerned to strengthen their links with the euro area by participating in the SSM. Both Berlin and Brussels should support this dynamic. More generous financial support for those countries about to adopt the euro would strengthen the institutional convergence of the euro-outs with the EU-19. It is essential to further promote the creation of a convergence facility within the EU Multiannual Financial Framework 2021-2027, an instrument proposed by the Commission to provide targeted support to Member States wishing to adopt the euro. This facility must be substantial enough to tackle huge structural challenges in the most likely euro candidate countries (Bulgaria, Romania, Croatia). It is questionable whether the 2.16 billion euros currently proposed for the seven-year financial framework will be sufficient to force structural changes and act as an incentive.

In addition, the European Commission should also articulate more clearly the advantages of membership of the eurozone compared to the risks. Belonging to the euro area can increase financial stability, reduce financing costs and provide access to the ECB and ESM facilities. Full participation in the SSM would be particularly advantageous to those euro-outs whose banking sectors are dominated by foreign ownership (Croatia, Romania and the Czech Republic).

The Franco-German tandem could emerge stronger from Brexit because of the power gained by Berlin and Paris. However, there are doubts as to whether both countries will be able to make effective use of this potentially more influential position against a backdrop of growing domestic challenges and the ongoing reform process in the eurozone.

The fear of euro-outs being marginalised could jeopardise new integration projects in the euro area. The group of ten northern states has been mistrustful of Franco-German proposals on further eurozone reforms. Further initiatives on deeper economic integration must ensure they do not exclude smaller EU Member States. Germany should, therefore, intensify its political contacts with countries in this group, in particular Denmark and Sweden, and encourage them to forge closer links to the economic governance of the euro area by participating in the SSM.

Further eurozone enlargement is in the interests of both Germany and the EU. This could reduce both the problems associated with the dual nature of economic governance in the EU and the risk of fragmentation of the internal market, which is a factor in the further development of the banking union. However, the most important condition for further accessions to the euro is the lasting stabilisation of the eurozone itself. Nevertheless, the remaining question concerning fiscal stability in Italy does not currently offer favourable conditions for a discussion on reforms and enlargement of the euro area (see SWP-Aktuell 52/2018).

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